

Message Text

PAGE 01 STATE 250453

72

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DRAFTED BY:TREASURY:RALPH V. KORP

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TO ALL DIPLOMATIC AND CONSULAR POSTS PRIORITY

AMEMBASSY NOUAKCHOTT PRIORITY

UNCLAS STATE 250453

INFORM CONSULS

E.O. 11652: N/A

SUBJECT: CHANGES IN U.S. CAPITAL OUTFLOW RESTRAINT PROGRAMS

1. THE TREASURY AND COMMERCE DEPARTMENTS AND FEDERAL RESERVE BOARD HAVE ANNOUNCED NEW CHANGES IN VARIOUS U.S. PROGRAMS RESTRAINING CAPITAL OUTFLOWS. FOLLOWING ARE TEXTS OF PRESS RELEASES MADE SIMULTANEOUSLY ON DECEMBER 26, 1973.

2. TREASURY DEPARTMENT NOTE TO CORRESPONDENTS:

THE UNITED STATES IS MAKING NEW ADJUSTMENTS IN THE UNCLASSIFIED

PAGE 02 STATE 250453

VARIOUS PROGRAMS THAT RESTRAIN CAPITAL FLOWS OUT OF THE COUNTRY. THESE MODIFICATIONS ARE IN LINE WITH THE ADMINISTRATION'S OBJECTIVE OF PHASING OUT THE RESTRAINT PROGRAMS. DETAILS OF THESE ACTIONS ARE DESCRIBED IN

SEPARATE ANNOUNCEMENTS MADE TODAY BY THE TREASURY AND COMMERCE DEPARTMENTS AND THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

THE MEASURES TAKEN ARE CONSISTENT WITH THE IMPROVEMENT WHICH IS TAKING PLACE IN THE UNITED STATES BALANCE-OF-PAYMENTS POSITION AND WITH A DESIRE TO ELIMINATE BARRIERS TO INTERNATIONAL CAPITAL MOVEMENTS. IN THE SAME CONTEXT, THE TREASURY DEPARTMENT WILL BE CONFERRING WITH THE CONGRESS DURING 1974 ON THE QUESTION OF ELIMINATING THE WITHHOLDING AND ESTATE TAXES APPLICABLE TO FOREIGN INVESTORS IN THE UNITED STATES.

3. TREASURY DEPARTMENT RELEASE ENTITLED
"INTEREST EQUALIZATION TAX REDUCED"

THE TREASURY DEPARTMENT TODAY ANNOUNCED THAT, PURSUANT TO AN EXECUTIVE ORDER SIGNED BY THE PRESIDENT, THE INTEREST EQUALIZATION TAX (IET) APPLICABLE TO ACQUISITIONS OF FOREIGN STOCK AND FOREIGN DEBT OBLIGATIONS WILL BE REDUCED FROM THE PRESENT RATE OF APPROXIMATELY THREE QUARTERS OF ONE PERCENT TO A NEW RATE OF APPROXIMATELY ONE QUARTER OF ONE PERCENT. THE NEW LOWER IET RATE SCHEDULE WILL BE APPLICABLE TO TRADES AND ACQUISITIONS OF FOREIGN STOCK OR OBLIGATIONS MADE AFTER DECEMBER 31, 1973.

THE IET HAS BEEN IN EFFECT SINCE JULY, 1963, AS A MEANS OF HELPING TO RESTRAIN FLOWS OF CAPITAL FROM THE UNITED STATES INTO PORTFOLIO INVESTMENTS IN OTHER DEVELOPED COUNTRIES. UNDER THE IET LAW, THE PRESIDENT HAS AUTHORITY TO VARY THE EFFECTIVE RATE OF TAX BETWEEN ZERO AND THE EQUIVALENT OF ONE AND ONE HALF PERCENT PER ANNUM ON PURCHASES OF FOREIGN SECURITIES SUBJECT TO THE TAX. THE UNCLASSIFIED

PAGE 03 STATE 250453

LAST CHANGE IN THE RATE OF THE TAX WAS ON APRIL 5, 1969, WHEN IT WAS REDUCED FROM ONE AND ONE QUARTER PERCENT TO THREE QUARTERS PERCENT PER ANNUM.

3. DEPARTMENT OF COMMERCE, OFFICE OF FOREIGN
DIRECT INVESTMENTS RELEASE ENTITLED "OFDI PROGRAM
LIBERALIZED FOR 1974"

ROBERT H. ENSLOW, DIRECTOR, OFFICE OF FOREIGN DIRECT INVESTMENTS OF THE DEPARTMENT OF COMMERCE, ANNOUNCED TODAY THE FOLLOWING LIBERALIZATION IN THE FOREIGN DIRECT INVESTMENT PROGRAM EFFECTIVE FOR 1974.

1. THE MINIMUM WORLDWIDE ALLOWABLE AVAILABLE TO SMALLER DIRECT INVESTORS WILL BE RAISED FROM \$10 MILLION TO \$20 MILLION.

2. THE EARNINGS ALLOWABLE WILL BE INCREASED FROM 60 PERCENT TO 100 PERCENT OF FOREIGN AFFILIATE EARNINGS FOR EITHER 1973 OR 1974, AT THE DIRECT INVESTOR'S ELECTION. THIS WILL PERMIT COMPLIANCE WITH THE REGULATIONS WITHOUT THE NECESSITY OF FOREIGN EARNINGS REMITTANCE.

3. A NEW "DEBT REPAYMENT ALLOWABLE" WILL BE ADDED TO THE REGULATIONS WHICH WILL AUTHORIZE A DIRECT INVESTOR TO REPAY 20 PERCENT OF ITS TOTAL OUTSTANDING FOREIGN BORROWING ALLOCATED TO POSITIVE DIRECT INVESTMENT AS OF THE END OF THE 1973 COMPLIANCE YEAR. THIS REPAYMENT ALLOWABLE WILL BE IN ADDITION TO THE MINIMUM, HISTORICAL AND EARNINGS ALLOWABLES. THE MINIMUM, HISTORICAL AND EARNINGS ALLOWABLE WILL NOT, HOWEVER, BE AVAILABLE FOR DEBT REPAYMENT AND DIRECT INVESTORS WILL NOT BE PERMITTED TO REDUCE OUTSTANDING FOREIGN DEBT BELOW 80 PERCENT OF AMOUNT ALLOCATED EFFECTIVE AS OF YEAR-END 1973. THE REGULATIONS WILL OPERATE TO PERMIT REPAYMENT OF SPECIFIC OUTSTANDING DEBT OBLIGATIONS, BUT DIRECT INVESTORS WILL BE REQUIRED TO REFINANCE AGGREGATE REPAYMENTS IN EXCESS OF THE 20 PERCENT REPAYMENT ALLOWABLE. RELIEF FOR BORROWING HARDSHIP UNCLASSIFIED

PAGE 04 STATE 250453

SITUATIONS WILL CONTINUE TO BE AVAILABLE THROUGH SPECIFIC AUTHORIZATION.

MR. ENSLOW STATED THAT THE 1974 LIBERALIZATION IS IN ACCORDANCE WITH THE NIXON ADMINISTRATION'S COMMITMENT TO ELIMINATE CAPITAL CONTROLS BY THE END OF 1974. THESE CHANGES WILL SUBSTANTIALLY REDUCE THE BURDEN ON DIRECT INVESTORS TO FINANCE FOREIGN INVESTMENT WITH NEW LONG-TERM FOREIGN BORROWING, WHILE AT THE SAME TIME MODERATING ANY ADVERSE IMPACT ARISING FROM REPAYMENT OF EXISTING FOREIGN BORROWING. MR. ENSLOW SAID THAT THE TEXT OF THE AMENDMENTS TO THE REGULATIONS WILL BE PUBLISHED IN THE FEDERAL REGISTER IN THE NEAR FUTURE.

4. FEDERAL RESERVE RELEASE

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM TODAY ISSUED AMENDMENTS TO ITS VOLUNTARY FOREIGN CREDIT RESTRAINT (VFCR) GUIDELINES THAT WILL INCREASE FOREIGN LENDING AND INVESTMENT CEILINGS FOR BANKS AND OTHER FINANCIAL INSTITUTIONS SUBJECT TO

THE PROGRAM AND THAT WILL ELIMINATE DIFFERENCES IN THE DEGREES OF RESTRAINT ON LENDING IN DEVELOPED COUNTRIES.

THE ANNOUNCEMENT IS BEING MADE IN CONJUNCTION WITH ACTIONS BY THE TREASURY AND COMMERCE DEPARTMENTS TO CHANGE THE INTEREST EQUALIZATION TAX (IET) AND THE FOREIGN DIRECT INVESTMENT REGULATIONS. THE THREE PROGRAMS CONSTITUTE A SET OF RESTRAINTS ON CAPITAL OUTFLOW THAT HAVE BEEN PART OF AN OVERALL GOVERNMENT PROGRAM TO HELP THE U.S. BALANCE OF PAYMENTS. THE FEDERAL RESERVE HAS ADMINISTERED THE VFCR PROGRAM SINCE EARLY 1965 AT THE REQUEST OF THE PRESIDENT.

THE VFCR AMENDMENTS APPROVED BY THE BOARD, EFFECTIVE JANUARY 1, 1974 ARE AS FOLLOWS:

1) THE PRESENT CEILING FOR EACH COMMERCIAL BANK IS INCREASED TO \$10 MILLION OR TO AN AMOUNT 4 PER UNCLASSIFIED

PAGE 05 STATE 250453

CENT ABOVE THE CEILING IN EFFECT IMMEDIATELY PRIOR TO THE PRESENT REVISION. HERETOFORE CEILINGS HAVE RANGED UPWARD IN SIZE FROM \$500,000, DEPENDING ON THE SIZE OF THE BANK OR ON ITS HISTORICAL RECORD IN FOREIGN LENDING. BANKS WITHOUT CEILINGS COULD HOLD FOREIGN ASSETS OF TYPES SUBJECT TO RESTRAINT UP TO THE LESSER OF (A) \$500,000 OR (B) 2 PER CENT OF THEIR END-OF-1970 TOTAL ASSETS. UNDER THE AMENDMENT, THE \$500,000 MINIMUM FIGURE FOR BANKS WITH CEILINGS IS NOW \$10 MILLION. BANKS PREVIOUSLY WITHOUT CEILINGS BUT ADOPTING THEM UNDER THE AMENDMENT WILL BE EXPECTED TO OBSERVE THE ESTABLISHED PRINCIPLE THAT THE CEILINGS ARE FOR LOANS GENERATED DIRECTLY BY THE "NEWCOMER" BANK AND NOT FOR LOANS INITIATED BY OTHER U.S. BANKS.

2) THE REQUEST THAT BANKS REFRAIN FROM MAKING NON-EXPORT LOANS WITH MATURITIES OF OVER ONE YEAR TO RESIDENTS OF THE DEVELOPED COUNTRIES OF CONTINENTAL WESTERN EUROPE IS LIMINATED. SUCH LOANS BY A BANK WILL BE LEFT TO COMPETE FOR THE BANK'S AVAILABLE GUIDELINE CEILING WITH LOANS TO BORROWERS IN OTHER FOREIGN AREAS. IN GENERAL, SUCH LOANS ARE, AND WILL AT THIS TIME REMAIN, SUBJECT TO THE IET.

3) U.S. AGENCIES AND BRANCHES OF FOREIGN BANKS WILL HAVE A CEILING OF AT LEAST \$10 MILLION FOR MAKING FOREIGN LOANS AND OTHER INVESTMENTS OF TYPES RESTRAINED UNDER THE PROGRAM. THE PRESENT MINIMUM CEILING IS \$1,000,000.

4) AGENCIES AND BRANCHES WILL BE ABLE TO RECALCULATE

THE "BASE NET FOREIGN POSITION", WHICH DETERMINES THE RELATIONSHIP BETWEEN THEIR FOREIGN LENDING AND FOREIGN BORROWING, BY USING 96 PERCENT OF THEIR FOREIGN LIABILITIES FOR JUNE 30, 1973. THEY WILL THEREBY BE ALLOWED TO INCREASE FOREIGN ASSETS, OR TO DECREASE FOREIGN LIABILITIES, BY APPROXIMATELY 4 PER CENT FROM AMOUNTS DETERMINED BY THE PREVIOUS FORMULA.

5) THE RESTRAINT AGAINST TERM LOANS TO THE
UNCLASSIFIED

PAGE 06 STATE 250453

DEVELOPED COUNTRIES OF CONTINENTAL WESTERN EUROPE WILL BE DROPPED FOR AGENCIES AND BRANCHES, AS IT IS BEING DROPPED FOR BANKS.

6) THE CEILING OF EACH NONBANK FINANCIAL INSTITUTION (WHICH INCLUDES, AMONG OTHERS, INSURANCE COMPANIES, FINANCE COMPANIES, AND MUTUAL FUNDS) WILL BE INCREASED TO AN AMOUNT 5 PERCENT ABOVE THAT IN EFFECT AT THE END OF 1972 OR TO \$2 MILLION, WHICHEVER IS HIGHER.

7) THE REQUEST THAT NONBANK FINANCIAL INSTITUTIONS REFRAIN FROM INCREASING THEIR LOANS AND INVESTMENTS IN THE DEVELOPED COUNTRIES OF CONTINENTAL WESTERN EUROPE BEYOND THE AMOUNT HELD AT THE END OF 1968 IS ELIMINATED. ANY INCREASE IN SUCH INVESTMENTS IS LEFT TO COMPETE FOR AVAILABLE LATITUDE UNDER AN INSTITUTION'S GUIDELINE CEILING WITH OTHER FOREIGN LOANS AND INVESTMENTS. THE IET WILL CONTINUE TO APPLY TO SOME OF THESE LOANS AND INVESTMENTS.

8) PERIODIC REPORTS WILL CONTINUE TO BE FILED BY ALL BANKING INSTITUTIONS WITH \$500,000 OR MORE IN FOREIGN ASSETS AND BY ALL NONBANK FINANCIAL INSTITUTIONS WITH \$500,000 OR MORE IN FOREIGN ASSETS OF TYPES SUBJECT TO RESTRAINT OR WITH \$5 MILLION OR MORE TOTAL FOREIGN ASSETS.

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